

AMENDED IN ASSEMBLY MAY 20, 2003

AMENDED IN ASSEMBLY MAY 8, 2003

AMENDED IN ASSEMBLY MAY 6, 2003

CALIFORNIA LEGISLATURE—2003–04 REGULAR SESSION

ASSEMBLY BILL

No. 1622

Introduced by Assembly Member Wyland

February 21, 2003

An act to amend Sections ~~23803, 23806, and 23809~~ *23803 and 23806* of the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 1622, as amended, Wyland. Bank and corporation tax: ~~“S corporation”~~ *“S” corporation*.

The Corporation Tax Law provides that, for taxable years beginning on or after January 1, 2002, corporations that have elected to be taxed as ~~“S corporations”~~ *“S” corporations* for federal tax purposes are deemed to be ~~“S corporations”~~ *“S” corporations* for California income tax purposes, unless the entity is prohibited from being a California ~~“S corporation”~~ *“S” corporation*. The Corporation Tax Law, in modified conformity to federal income tax laws, provides for the specified tax treatment of ~~“S corporations”~~ *“S” corporations* and their shareholders. Among other things, that law requires that an election made under federal income tax laws, relating to certain stock purchases treated as asset acquisitions, be treated as an election for state tax purposes, specifies the application of credits to reduce the entity level tax, and

imposes a tax on built-in gains attributable to California sources, as provided.

This bill, for taxable years beginning on or after January 1, 2004, would allow an ~~“S corporation,”~~ “S” corporation, as provided, to carry forward a net operating loss incurred by that corporation as a ~~“C corporation,”~~ “C” corporation from its last taxable year beginning before January 1, 2002, to the first taxable year beginning on or after January 1, 2004, in which the corporation is treated as an ~~“S corporation,”~~ “S” corporation for state tax purposes as a result of the enactment of Chapter 35 of the Statutes of 2002. This bill would also allow an ~~“S corporation,”~~ “S” corporation to carry forward the full amount of tax credits generated by that corporation as a ~~“C corporation,”~~ “C” corporation to the first taxable year beginning on or after January 1, 2003, in which the corporation is deemed to be an ~~“S corporation,”~~ “S” corporation for state tax purposes pursuant to Chapter 35 of the Statutes of 2002. *This bill would specify the method of calculating the amount of carryover tax credit available to the corporation as of January 1, 2003.* This bill would also prohibit ~~utilization~~ the carryover of any net operating loss ~~carryover against~~ utilized to reduce net built-in gain recognized by the corporation, as provided.

This bill would incorporate additional changes in Section 23803 of the Revenue and Taxation Code proposed by AB 967, to be operative only if AB 967 and this bill are both chaptered and become effective January 1, 2004, and this bill is enacted after AB 967.

This bill would take effect immediately as a tax levy.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

- 1 SECTION 1. Section 23803 of the Revenue and Taxation
- 2 Code is amended to read:
- 3 23803. (a) (1) With respect to credits that are otherwise
- 4 allowed to reduce the taxes imposed under this part:
- 5 (A) The amount of any credit to be claimed is limited to
- 6 one-third of the amount otherwise allowable.
- 7 (B) (i) Any unused portion of the credit allowable under
- 8 subparagraph (A) (one-third of the total credit) is allowed to be

1 carried forward and may not be subject to additional reductions
2 under subparagraph (A) in later years.

3 (ii) No carryforward is allowed for the portion of the credit
4 denied under subparagraph (A) (two-thirds of the total credit).

5 (C) Credits carried forward from taxable years beginning prior
6 to the first taxable year in which the corporation is treated as an “S
7 corporation” under this part, shall be reduced in accordance with
8 subparagraph (A) for that first taxable year and may not be subject
9 to additional reductions under subparagraph (A) in later years.

10 (D) (i) (I) Notwithstanding any other provision of law,
11 subparagraph (A) of paragraph (1) of this subdivision does not
12 apply to credits generated by a corporation that is described in
13 clause (ii) of this subparagraph and carried forward from the last
14 taxable year beginning before January 1, 2002, in which that
15 corporation was treated as a “C corporation,” to the first taxable
16 year beginning on or after January 1, 2003, in which the
17 corporation is treated as an “S corporation” pursuant to the
18 enactment of Chapter 35 of the Statutes of 2002. The credits that
19 are carried forward from the last taxable year of the “C
20 corporation” beginning before January 1, 2002, may not be
21 reduced in later years and may be utilized to offset the tax imposed
22 under either Section 23151 or Section 23501.

23 (II) *For purposes of this section, for taxable years beginning on*
24 *or after January 1, 2003, the amount of credit available to a*
25 *corporation, described in clause (ii) of subparagraph (D) of this*
26 *subdivision, is the amount of credit carried forward from the*
27 *corporation’s last taxable year beginning before January 1, 2002,*
28 *in which the corporation was treated as a “C” corporation, and*
29 *calculated without the limitations imposed by subparagraph (A)*
30 *of paragraph (1) of this subdivision, less the amount of credit*
31 *claimed by the corporation for its 2002 taxable year.*

32 (ii) This subparagraph applies to a corporation that, for its last
33 taxable year beginning before January 1, 2002, was an “S
34 corporation” for federal income tax purposes and a “C
35 corporation” for purposes of Part 10 (commencing with Section
36 17001), Part 10.2 (commencing with Section 18401), and this part,
37 and, as a result of the enactment of Chapter 35 of the Statutes of
38 2002, is an “S corporation” for the corporation’s taxable year
39 beginning on or after January 1, ~~2003~~ 2002.

(E) Paragraphs (2) and (3) of subdivision (f) of Section 23802 apply prior to the reduction required by subparagraph (A).

(F) No portion of any credit to which this paragraph applies may be passed through to the shareholders of the “S corporation.”

(G) This paragraph does not affect the amount of any credit computed under Part 10 (commencing with Section 17001) for pass-through to shareholders in accordance with the provisions of Section 1366 of the Internal Revenue Code.

(2) With respect to credits that are allowed to the “S corporation” only because it is treated in the same manner as an individual, the provisions of Section 1366(a) of the Internal Revenue Code shall be modified to provide that the shareholder’s pro rata share of the corporation’s credits shall include the credit for political contributions allowed under Section 17053.14.

(b) Section 1366(f) of the Internal Revenue Code, relating to special rules, is modified as follows:

(1) The amount of tax used to compute the reduction allowed by Section 1366(f)(2) is the amount of tax imposed on built-in gains under this part.

(2) The amount of tax used to compute the reduction allowed by Section 1366(f)(3) is the amount of tax imposed on excess net passive income under this part.

(c) The amendments to this section made by this act shall apply to taxable years beginning on or after January 1, 2003.

SEC. 1.5. Section 23803 of the Revenue and Taxation Code is amended to read:

23803. (a) ~~(1)~~ With respect to credits ~~which~~ *that* are otherwise allowed to reduce the taxes imposed under this part:

~~(A)–~~

(1) The amount of any credit to be claimed ~~shall be~~ *is* limited to one-third of the amount otherwise allowable.

~~(B)–(i)–~~

(2) (A) Any unused portion of the credit allowable under ~~subparagraph (A) paragraph (1)~~ *paragraph (1)* (one-third of the total credit) ~~shall be~~ *is* allowed to be carried forward and ~~shall~~ *may* not be subject to additional reductions under ~~subparagraph (A) paragraph (1)~~ *paragraph (1)* in later years.

~~(ii)–~~

(B) No carryforward ~~shall be~~ is allowed for the portion of the credit denied under ~~subparagraph (A)~~ paragraph (1) (two-thirds of the total credit).

(C) Credits carried forward from taxable years beginning prior to the first taxable year in which the corporation is treated as an “S corporation” “S” corporation under this part, shall be reduced in accordance with ~~subparagraph (A)~~ paragraph (1) for that first taxable year and ~~shall~~ may not be subject to additional reductions under ~~subparagraph (A)~~ paragraph (1) in later years.

(D) ~~The provisions of paragraphs~~

(i) (I) Notwithstanding any other provision of law, paragraph (1) of this subdivision does not apply to credits generated by a corporation that is described in clause (ii) of this subparagraph and carried forward from the last taxable year beginning before January 1, 2002, in which that corporation was treated as a “C” corporation, to the first taxable year beginning on or after January 1, 2003, in which the corporation is treated as an “S” corporation pursuant to the enactment of Chapter 35 of the Statutes of 2002. The credits that are carried forward from the last taxable year of the “C” corporation beginning before January 1, 2002, may not be reduced in later years and may be utilized to offset the tax imposed under either Section 23151 or Section 23501.

(II) For purposes of this section, for taxable years beginning on or after January 1, 2003, the amount of credit available to a corporation, which is described in clause (ii) of subparagraph (D), is the amount of credit carried forward from the corporation’s last taxable year beginning before January 1, 2002, in which the corporation was treated as a “C” corporation, and calculated without the limitations imposed by paragraph (1), less the amount of credit claimed by the corporation for its 2002 taxable year.

(ii) This subparagraph applies to a corporation that, for its last taxable year beginning before January 1, 2002, was an “S” corporation for federal income tax purposes and a “C” corporation for purposes of Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), and this part, and, as a result of the enactment of Chapter 35 of the Statutes of 2002, is an “S” corporation for the corporation’s taxable year beginning on or after January 1, 2003.

1 (E) Paragraphs (2) and (3) of subdivision (f) of Section 23802
2 ~~shall be applied~~ apply prior to the reduction required by
3 ~~subparagraph (A) paragraph (1).~~

4 (E) —

5 (F) No portion of any credit to which this paragraph
6 subdivision applies ~~shall be~~ may passed through to the
7 shareholders of the “S corporation.”

8 (F) The provisions of this paragraph shall “S” corporation.

9 (G) The provisions of this subdivision do not affect the amount
10 of any credit computed under Part 10 (commencing with Section
11 17001) for ~~pass-through~~ pass-through to shareholders in
12 accordance with the provisions of Section 1366 of the Internal
13 Revenue Code.

14 (2) ~~With respect to credits which are allowed to the “S~~
15 ~~corporation” only because it is treated in the same manner as an~~
16 ~~individual, the provisions of Section 1366(a) of the Internal~~
17 ~~Revenue Code shall be modified to provide that the shareholder’s~~
18 ~~pro rata share of the corporation’s credits shall include the credit~~
19 ~~for political contributions allowed under Section 17053.14.~~

20 (b) Section 1366(f) of the Internal Revenue Code, relating to
21 special rules, ~~shall be~~ is modified as follows:

22 (1) The amount of tax used to compute the ~~reduction loss~~
23 allowed by Section 1366(f)(2) ~~shall be~~ is the amount of tax
24 imposed on built-in gains under this part.

25 (2) The amount of tax used to compute the reduction allowed
26 by Section 1366(f)(3) ~~shall be~~ is the amount of tax imposed on
27 excess net passive income under this part.

28 (c) The amendments to this section made by this act shall apply
29 to taxable years beginning on or after January 1, 2003.

30 SEC. 2. Section 23806 of the Revenue and Taxation Code is
31 amended to read:

32 23806. (a) Section 1371(a) of the Internal Revenue Code,
33 relating to application of Subchapter C rules, is modified to
34 provide that, notwithstanding subdivisions (a) and (e) of Sections
35 17024.5 and 23051.5, any election by an “S corporation” or its
36 shareholders under Section 338 of the Internal Revenue Code,
37 relating to certain stock purchases treated as asset acquisitions, for
38 federal purposes is treated as an election for purposes of this part
39 and a separate election under paragraph (3) of subdivision (e) of
40 Section 17024.5 or 23051.5 is not allowed.

(b) No election under Section 338 of the Internal Revenue Code, relating to certain stock purchases treated as asset acquisitions, is allowed for state tax purposes unless the “S corporation” or its shareholders made a valid election for federal income tax purposes under Section 338 of the Internal Revenue Code.

(c) (1) Section 1371(b)(1) of the Internal Revenue Code is modified to provide that any corporation described in paragraph (2) is allowed to carry forward a net operating loss of the corporation as a “C corporation,” as allowed under this part, from the last taxable year beginning before January 1, 2002, to the first taxable year beginning on or after January 1, 2004, in which the corporation is treated as an “S corporation” pursuant to the enactment of Chapter 35 of the Statutes of 2002.

(2) This subdivision applies to a corporation that, for its last taxable year beginning before January 1, 2002, was an “S corporation” for federal income tax purposes and a “C corporation” for purposes of Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), and this part, and, as a result of the enactment of Chapter 35 of the Statutes of 2002, is an “S corporation” for the corporation’s taxable year beginning on or after January 1, 2004.

(3) *This subdivision does not apply to any net operating loss utilized as a deduction against net recognized built-in gain pursuant to Section 1374(b)(2) of the Internal Revenue Code, as modified by Section 23809.*

(d) Section 1371 (d) of the Internal Revenue Code does not apply.

(e) The amendments to this section made by this act shall apply to taxable years beginning on or after January 1, 2004.

~~SEC. 3.—Section 23809 of the Revenue and Taxation Code is amended to read:~~

~~23809.—There is hereby imposed a tax on built-in gains attributable to California sources, determined in accordance with the provisions of Section 1374 of the Internal Revenue Code, relating to tax imposed on certain built-in gains, as modified by this section.~~

~~(a) (1) The rate of tax specified in Section 1374(b)(1) of the Internal Revenue Code is equal to the rate of tax imposed under~~

~~Section 23151 in lieu of the rate of tax specified in Section 11(b) of the Internal Revenue Code.~~

~~(2) In the case of an “S corporation” which is also a financial corporation, the rate of tax specified in paragraph (1) shall be increased by the excess of the rate imposed under Section 23183 over the rate imposed under Section 23151.~~

~~(b) Section 1374(b)(2) of the Internal Revenue Code, relating to net operating losses, is modified to provide that any net operating loss allowed or allowable under subdivision (c) of Section 23806 is not allowed as a deduction against net recognized built-in gain.~~

~~(c) Section 1374(b)(3) of the Internal Revenue Code, relating to credits, shall be modified to provide that the tax imposed under subdivision (a) shall not be reduced by any credits allowed under this part.~~

~~(d) Section 1374(b)(4) of the Internal Revenue Code, relating to coordination with Section 1201(a), does not apply.~~

~~(e) In the case of a corporation that is subject to the provisions of former Section 1374 of the Internal Revenue Code (prior to amendment by Public Law 99-514), the provisions of that section are modified to provide that:~~

~~(1) The tax specified in Section 1374(b)(1) of the Internal Revenue Code is equal to the rate of tax imposed under Section 23151 in lieu of the rate of tax specified in Section 11(b) of the Internal Revenue Code.~~

~~(2) In the case of an “S corporation” that is also a financial corporation, the rate of tax specified in paragraph (1) shall be increased by the excess of the rate imposed under Section 23183 over the rate imposed under Section 23151.~~

~~(f) The amendments to this section made by this act shall apply to taxable years beginning on or after January 1, 2004.~~

SEC. 3. Section 1.5 of this bill incorporates amendments to Section 23803 of the Revenue and Taxation Code proposed by both this bill and AB 967. It shall only become operative if (1) both bills are enacted and become effective on or before January 1, 2004, (2) each bill amends Section 23803 of the Revenue and Taxation Code, and (3) this bill is enacted after AB 967, in which case Section 1 of this bill shall not become operative.

1 SEC. 4. This act provides for a tax levy within the meaning of
2 Article IV of the Constitution and shall go into immediate effect.

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